The Competition Law and Intellectual Property Interface

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Canadian businesses recognize the importance of innovation, and with good reason, since numerous studies and articles have identified innovation as important to companies’ survival in Canada. Innovation benefits consumers through the development of new products and services. Competition law and intellectual property (“IP”) law both encourage and regulate innovation, helping Canadian businesses achieve their full potential. However, each of these legal regimes must be implemented without harming the effectiveness of the other.

Navigating the intersection of IP law and competition law requires thoughtful consideration of both the timing and the nature of the government intervention. This article argues that competition law should focus only on the competitive impact of the use and transfer of IP rights, not on the size of the reward obtained for an innovator’s efforts. Competition law should be concerned with the result of the use and transfer of IP. IP law rewards efforts by assigning and protecting rights. Once rights have been assigned, competition law should not distinguish between IP and other forms of property. On the other hand, IP laws should not insulate economic actors from the application of the Competition Act. To this end, the article argues that:

1. the objectives of competition law and IP law are complementary;
2. the Competition Bureau’s (the “Bureau”) Intellectual Property Enforcement Guidelines (“IPEGs”) have been and must continue to be applied with the Bureau’s current restraint, otherwise innovation could be chilled; and
3. the recent Apotex Inc. v. Eli Lilly and Company decision of the Federal Court of Appeal (“FCA”) rightly reconfirms that patents should not
insulate anticompetitive activities from the application of the Competition Act.

COMPETITION LAW AND PATENT LAW OBJECTIVES

While IP law and competition law appear on their face to be incompatible—IP law creates limited government-sanctioned monopolies, whereas competition law seeks to eliminate monopoly power in general—they are in fact complementary. They have similar goals but different means of achieving them.

The objective of competition law is to maintain and encourage competition in Canada by prohibiting certain anticompetitive conduct. The objective of the IP rights system is to provide an incentive for innovation by granting enforceable property rights to inventors for a specific time period. For example, patent laws further the dissemination of innovation by requiring that in exchange for the right to exclude others from making, using, or selling the invention for a limited time, the inventor disclose his or her invention to the public. The primary policy consideration underlying the patent system is that the public will benefit by the disclosure of the innovation.

IP law is a legal regime that rewards innovation by limiting competition in the marketplace. In essence, IP law allows businesses to innovate and establish markets for their products in the absence of rigorous competition or the fear of free riding, which in turn allows inventors of new products to recoup the costs of their research and development. Without these financial rewards, businesses would have little incentive to innovate and invest in cost-intensive research and development.

IP law and competition law are complementary because they share the objective of promoting technical progress for the ultimate benefit of consumers. Firms are more likely to innovate if they are protected against free riders. However, even the completely legitimate use of IP rights can restrict competition (at least in the short term), resulting in a trade-off between the gains resulting from innovation and the benefits of increased competition. In economic terms, the trade-off is between dynamic efficiency (the goal of IP regimes) and allocative efficiency (the goal of competition policy), and it is a trade-off with significant economic consequences. “An antitrust policy that reduced prices by five percent today at the expense of reducing by one percent the annual rate at which innovation lowers the costs of production would be a calamity. In the long run, a continuous rate of change, compounded, swamps static losses.”
Stated differently, if the protection granted by IP rights were narrowed, resulting in a reduction in short-term prices, these prices might be closer to their true competitive level, thereby giving rise to short-term consumer welfare benefits. However, if one were to consider the losses that would arise from the reduced cost savings resulting from the lack of innovation (since economic agents would no longer have sufficient incentives to innovate), the trade-off would certainly run counter to longer-term consumer welfare gains.

The tension between IP law and competition law can be traced to the familiar problem of the public good. Without effective legal protection to prevent unauthorized use of IP, anyone could freely use and benefit from an innovation as soon as it became public knowledge. This is because all types of knowledge share one essential feature: they are non-rival—the use of an item of knowledge by one person in one application does not make its use by someone else in another application any more difficult. In addition, the marginal cost of supplying an item of knowledge to an additional user once the knowledge has been discovered is effectively nil. Therefore, if the price of knowledge were left to competitive market forces alone, the equilibrium competitive price would be close to zero. Under this competitive outcome, however, there would be little private incentive to create knowledge. It follows that either knowledge is sold above its marginal cost or its development is not motivated by market forces. Some departure from the competitive model is, therefore, required. IP laws resolve this issue by granting monopoly rights. Competition laws ensure that these rights do not become a vehicle for anticompetitive conduct.

Clearly, regulators are faced with a dilemma as they grapple with the challenges of protecting consumer welfare today while simultaneously ensuring that they are not inhibiting technological advancements that will further consumer welfare in the future. This tension can be regulated, since both areas of law aim to achieve efficiency in a market economy—competition law through allocative efficiency and IP law through dynamic efficiency.

The next section explores the current regulatory balance. In our regulatory regime, IP laws protect and reward innovation by assigning rights. The Competition Act regulates, with one notable exception, the use and transfer of rights.

The IPEGs state that IP is like any other type of property and the Competition Act applies to conduct involving IP rights to the same extent that it applies to conduct involving the exercise of other property rights.
those rights as it does the use and transfer of any other form of property. As set out below, the exception in Section 32 of the Competition Act distinguishes between IP rights and other forms of property.

COMPETITION BUREAU

Intellectual Property Enforcement Guidelines and the Competition Act

Business activities relating to the use, acquisition, licensing, and enforcement of patent rights may be challenged under the Competition Act.17 The Bureau’s approach to applying the Competition Act to patents and other IP is set out in the IPEGs, discussed below. The IPEGs apply to a broad range of conduct involving IP, in contrast to the U.S. Antitrust Guidelines for the Licensing of Intellectual Property,18 which focus exclusively on the licensing of IP.

The IPEGs state that IP is like any other type of property and the Competition Act applies to conduct involving IP rights to the same extent that it applies to conduct involving the exercise of other property rights—with the significant exception of Section 32, discussed below. When conduct involves “something more” than the mere exercise of an IP right, usually in the context of arrangements between competitors, the IPEGs state that the analysis will be the same as that generally applied under the Competition Act.19 For example, if an IP rights owner transfers or licenses the IP to an actual or a potential competitor in a way that creates, increases, or maintains market power, then the general provisions of the Competition Act may be violated. In the criminal context, where the courts have jurisdiction, these provisions include:

- conspiracy (Section 45);
- bid rigging (Section 47);
- price discrimination and predatory pricing (Section 50);
- misleading advertising and related deceptive marketing practices (Sections 52 to 55); and
- price maintenance (Section 61).

In civil matters where the Competition Tribunal has jurisdiction, the provisions deal with conduct that may in certain circumstances restrain competition. These reviewable matters include:

- misleading advertising and related deceptive marketing practices (Section 74);
- refusal to deal (Section 75);
exclusive dealing and tied selling (Section 77);
abuse of dominant position (Section 79); and
mergers (Section 92).

Courts and tribunals have issued a handful of decisions relating to IP under the criminal and civil provisions of the Competition Act. All apply the Competition Act to IP in a similar manner to the way they would to other property. Most recently in *Eli Lilly*, a case discussed in detail below, the FCA applied the Competition Act to the relevant IP rights consistently with these prior decisions. To date, the Bureau has not significantly interfered with IP rights.

The statutory exception in Section 32 of the Competition Act is a controversial provision that allows a court to impose remedies for the “mere” exercise of an IP right. Section 32 of the Competition Act permits a court to impose remedies when a rights holder has used its exclusive IP to unduly restrain trade or lessen competition. There is no corresponding provision in the laws of other major jurisdictions such as the United States and the European Union. Section 32 of the Competition Act (or a predecessor section granting similar remedial powers) has been in place in competition legislation since 1910. The provision was enacted out of concern by Canadian legislators that the exclusive rights granted under the Patent Act could unduly restrict trade or commerce. The section was repealed in 1937 by members of Parliament, who saw the restrictions on IP rights as threatening the incentive to innovate, which patent rights were intended to create. It was re-enacted in 1946 and broadened to include both trademarks and patents. The re-enactment followed the release of a government report that found that the Patent Act was not adequately protecting the public interest regarding the anticompetitive abuses of patents.

The *IPEGs* de-emphasize the possible impact of Section 32, stating that the Bureau will apply this provision only in the most unusual circumstances.

Specifically, the *IPEGs* state that Section 32 will be applied only when there is no remedy under the applicable IP laws and after applying a two-stage analysis as follows:

First, the refusal to license the intellectual property in question must have adversely and substantially affected competition in a market that is different or substantially larger than the subject matter of the intellectual property right. To satisfy this criterion, the holder of the intellectual property right must be dominant in the relevant market and the intellectual property must be an
essential input or resource for other firms that wish to compete in the relevant market; and

Second, the Bureau must be persuaded that the special remedy would not adversely alter the incentives to invest in research and development in the economy. This criterion would be satisfied if the refusal to license is stifling further innovation.

The *IPEGs* note that this multi-party test would be satisfied “only in very rare circumstances,” but might be satisfied in a network industry.\(^{27}\)

While Section 32 has been part of the Competition Act framework for many years, it has seldom been used.\(^ {28}\) No significant reported decisions have discussed Section 32 of the Competition Act and its implications for IP law matters since the *IPEGs* were issued. The *IPEGs* have elicited very little comment from either the courts or the Competition Tribunal. However, Section 32 has been subject to critical remarks from commentators.\(^ {29}\) The Bureau has exercised appropriate restraint in enforcing Section 32 of the Competition Act. This restraint indicates that the Bureau understands that IP is an important factor in increasing productivity and competition in the Canadian economy.

The *IPEGs* describe circumstances in which the Bureau may intervene: in policy discussions, in Federal Court cases, and at other times when it is important to bring a competition law perspective to the proceedings. To date, however, it seems that the Bureau has exercised this mandate once only—recently in the patent case of *Eli Lilly*,\(^ {30}\) discussed further below.

The final section of the *IPEGs* includes hypothetical situations to illustrate the Bureau’s enforcement approach.\(^ {31}\) Most of these examples relate to the application of the Competition Act’s general provisions to IP rights. However, one example applies Section 32 of the Competition Act with the restraint set out in the body of the *IPEGs*, reiterating that the mere exercise of IP rights will rarely give rise to problems under the Competition Act.

**ELI LILLY**

The recent *Eli Lilly* case demonstrates that disagreement often exists about what conduct goes beyond the “mere exercise” of an IP right and what is anticompetitive behavior that constitutes “something more.” This case also demonstrates the differences in the timing and nature of regulatory intervention in the IP law and competition law regimes.
In *Eli Lilly*, Apotex, a generic drug manufacturer, was sued by Eli Lilly for infringement of eight patents that relate to the drug cefaclor. The eight patents together make up all processes to manufacture cefaclor, providing Eli Lilly with a virtual economic monopoly on the drug in Canada. Apotex counterclaimed against Eli Lilly and another pharmaceutical company, Shionogi, which had assigned four of the allegedly infringed patents to Eli Lilly. In the counterclaim, Apotex alleged that the assignment of the patents constituted a conspiracy that resulted in an undue lessening of competition in violation of Section 45 of the Competition Act. On a motion for summary judgment, the Trial Division judge held that the allegations did not state a cause of action and granted summary judgment in favor of Eli Lilly and Shionogi. The Trial Division judge based his decision on an earlier FCA decision in *Molnlycke AB v. Kimberly-Clark of Canada Ltd.* In *Molnlycke*, the FCA found that the assignment of a patent and its subsequent enforcement by the assignee were no more than legitimate exercises of a patentee’s monopoly. All allegations of anticompetitive activity were struck out.

The Trial Division judge in *Eli Lilly* held that a patent provides its holder with a “legally sanctioned” monopoly under the Patent Act, and, thus, the assignment of a patent right “simply cannot, as a matter of law, result in the lessening of competition being undue during the life of the patent.” He interpreted *Molnlycke* to hold that the impairment of competition inherent in the exercise of rights specifically provided by the Patent Act can never be undue. On appeal, the FCA held that the trial judge ought to have considered whether Section 45 can ever apply to an agreement involving the exercise of patent rights when there is something more than the assignment itself. On reconsideration, the Trial Court found that the assignment of the patents had led to a lessening of competition because it increased Eli Lilly’s monopoly power. However, the agreement between Shionogi and Eli Lilly was an assignment of patents, and nothing more. The trial judge also found—contrary to the FCA’s instructions—that since the assignment of a patent is specifically authorized by the Patent Act, there was no cause of action under Section 45 of the Competition Act. Apotex once again appealed.

The Bureau did not announce an investigation of *Eli Lilly*, but sought leave to intervene in the latest appeal, arguing that the decision of the Trial Division would cause “great mischief” if upheld. In its written submissions on the leave application, the Bureau argued that the Trial Division judge’s approach was
inconsistent with the IPEGs. For example, the IPEGs specifically state that where:

an intellectual property owner licenses, transfers or sells the intellectual property to a firm or a group of firms that would have been actual or potential competitors without the arrangement, and if this agreement creates, enhances or maintains market power, the Bureau may seek to challenge the arrangement under the appropriate section of the Competition Act.

The FCA granted the Bureau leave to intervene on May 27, 2005, holding that it had standing to intervene because its ability to administer the Competition Act in respect of patent rights may be affected by the outcome of the case.

The FCA heard the appeal of the latest trial court decision in late September 2005 and released its decision on November 2, 2005, agreeing with the Bureau’s submissions. The decision focused on whether an assignment of a patent could unduly lessen competition if it increased the assignee’s market power to something more than that inherent in the patents. And if so, did the assignment of patents by Shionogi to Eli Lilly unduly lessen competition?

The FCA found that the ability to assign a patent under Section 50 of the Patent Act did not shield the rights holder from Section 45 of the Competition Act when it increased the assignee’s market power beyond that inherent in the patent right assigned. Justice Evans of the FCA determined that when the assignment or transfer of a patent unduly lessened competition, Parliament did not intend to exclude patent rights from the application of the Competition Act.

The FCA distinguished Molnlycke from Eli Lilly on its facts because the only market power involved in the assignment in Molnlycke was that inherent in the patent assigned. In Molnlycke, there was no increase in market power as a result of the assignment. In Eli Lilly, the case at hand, the assignment of patents by Shionogi to Eli Lilly resulted in a lessening of competition.

Patent rights holders and other IP rights holders should carefully consider whether the assignment or transfer of their rights leads to a lessening of competition, potentially offending the provisions of Competition Act as set out in the most recent decision of the FCA. It is too soon to tell whether the FCA will have the last word on this issue or whether the most recent decision will be appealed to the Supreme Court of Canada.

Eli Lilly is an example of the courts—and the Bureau—distinguishing the legitimate exercise of IP rights from their use for anticompetitive purposes. The Trial Division’s decision appears to insulate patent licensing agreements from
scrutiny under the Competition Act in all circumstances. Patent law should not
insulate economic actors from the application of the Competition Act to their
competitive practices. The FCA’s decision clarified this aspect of the relationship
between IP and competition law. The FCA held that an assignment of patents is
not exempt from the Competition Act, when by virtue of the assignor’s existing
ownership of other patents, the assignment transfers more market power than
that inherent in the patents assigned. The trial judge’s decision, had it been
upheld by the FCA, would have treated IP as a distinctly different form of
property, immune from challenge under the Competition Act and the IPEGs, and
would have allowed holders of IP rights to engage in anticompetitive conduct.

CONCLUSION

As markets change and innovators face global competition and legal
uncertainty about ownership of their creative knowledge-based products,
regulators need to continue to focus on the relationship between IP law
and competition law—laws that affect and protect innovation. Innovation is promoted through (1) re-
warding innovation and establishing legal certainty through the
granting of IP rights; and (2) the thoughtful enforcement of competition law. To
achieve these goals, regulatory authorities must pay increasing attention to the
relationship between these two areas of law.

The IPEGs and the Competition Act give businesses the flexibility to
structure, manage, and market their products provided they deliver the right
competitive results ex post with meaningful penalties for any failure to achieve
the stipulated competitive outcome. The Bureau’s basic approach specifies what
is to be achieved and leaves it to the creativity of businesses to determine how
best to innovate and promote efficient business practices while meeting those
competition law objectives.

Section 32 allows the Bureau to interfere ex post in the creation of IP rights
previously granted ex ante by the IP law regimes. To date, the Bureau has rightly
not been concerned with the trade-offs already made in the granting of patents
under the IP rights regime. It has avoided an unnecessary chilling effect on
innovation. By interfering ex post with the scope and length of the allocation of
patent rights, the Bureau could skew the relative returns that inventors could

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obtain and could constrain innovative conduct. We understand the keen interest in getting the right result in the Canadian marketplace, but the Bureau’s current focus on output regulation, or flexible effects-based enforcement, with the application of the general provisions of the Competition Act to IP, is not only an acceptable way to regulate, but a preferable one. Competition law should treat all businesses equally. The application of Section 32 without the current restraint would amount to a significant restructuring of the Canadian regulatory landscape with unintended consequences that procompetitive activities, such as the innovation of new products and services, could be chilled if inventors feared that the Bureau would interfere with their IP rights \textit{ex post}.

As well, IP law should not insulate economic actors from competition law objectives. While certain conduct is clearly permitted by IP laws, notwithstanding the impact of such conduct on competition, competition law has a role to play in ensuring that IP laws do not become a method to achieve certain anticompetitive outcomes.\textsuperscript{39} \textit{Eli Lilly}, as decided by the FCA in confirming that the Competition Act applies to the transfer of patents, is a welcome development in ensuring that IP laws do not insulate economic actors from the consequences of anticompetitive behavior.

Simply put, the complementary intersection between IP law and competition law can be found in thoughtful consideration of the timing of government intervention—\textit{ex ante} for IP law in defining and protecting IP rights and \textit{ex post} for competition law in managing the use of those rights—along with thoughtful consideration of the impact of government intervention on encouraging innovation.

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5. Patent law does not necessarily confer on
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the owner of a patent the right to seek monopoly rents in economic terms. Close substitutes may eliminate the possibility for the inventor to realize these, as with other forms of property. Makan Delrahim, *Contemporary Issues at the Intersection of Intellectual Property and Antitrust*, Paper Presented to The Fair Competition & Market Economy 2004 Shanghai International Forum (unpublished).


8. An example of free riding in this context would be an individual acquiring a software program by copying it from a friend, thereby avoiding the cost of purchasing the program and reducing the private economic returns to the software developer.

9. This is in an addition to the trade-offs already made in the granting of patents under the IP rights regime.

10. Obtaining the most consumer satisfaction over time. This definition accounts for the fact that the IP is a new resource that allows the economy to produce and consume more of certain goods without having to reduce production and consumption of other goods.

11. Obtaining the most consumer satisfaction from available resources. This is what most economists mean when the term “efficiency” arises. The economy is analyzed at a point in time. Given fixed resource constraints, this definition accounts for the fact that output and consumption of a certain good cannot be raised without output and consumption of other goods necessarily being reduced. In theory and assuming perfectly competitive markets, allocative efficiency requires that the price of all goods be equal to the additional cost that would be incurred to produce an additional unit of that good.


14. Conversely, rival goods, which include most conventional private economic goods, cannot simultaneously be consumed by different individuals.

15. See supra note 11.


17. Generally, supra note 6.


19. IPEGs, supra note 3, § 4.2.1.

20. For example, see Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc. (1997), 73 C.P.R. (3d) 1 (Comp. Trib.); Canada (Director of Investigation and Research) v. Warner Music Canada Inc. (1997), 78 C.P.R. (3d) 321 (Comp. Trib.).

21. Competition Act, supra note 6, § 32.


24. See supra note 22.


26. See supra note 13, at 597.

27. IPEGs, supra note 3, § 4.2.2.

28. See supra note 13, at 634.

29. Richard Ellis, *Submission of the National

30. Eli Lilly, supra note 4.

31. These examples deal with situations of alleged infringement of an intellectual property right, price fixing, exclusive licensing, foreclosure by purchaser, foreclosure by suppliers, exclusive contracts, output royalties, patent pooling arrangements, agreement to foreclose complementary products, and refusal to license a standard.


36. Eli Lilly, supra note 4, Factum of the Intervenor, para. 15.


38. Eli Lilly, supra note 4, para. 19.